

## Internal Revenue Service

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### LEGEND:

Trust =

A =

Year =

X =

State =

Date 1 =

B =

a =

C =

b =

c =

d =

e =

f =

g =

h =

Date 2 =

Order =

Court =

Date 3 =

Date 4 =

Dear :

This responds to the letter dated June 2, 2010, and subsequent correspondence, submitted on behalf of X and Trust, requesting rulings under section 1361(d) and (e) of the Internal Revenue Code (the Code).

#### FACTS

According to the information submitted, Trust was established pursuant to the will of A who died in Year. Trust holds stock in X, an S corporation organized under the laws of State. Effective Date 1, the Trust elected to be an electing small business trust (ESBT) within the meaning of section 1361(e)(3) of the Code.

Under the terms of Trust, the trustee is to first distribute specific dollar amounts of net income to certain named beneficiaries. B is the only named beneficiary still alive. B receives \$a of net income per month.

The trust agreement further provides that after making the payment to B, the income of Trust is to be divided into as many equal parts as there are grandchildren of A who are living, and grandchildren of A who have died leaving issue. C is the last remaining grandchild of A who is living. A has b grandchildren who died leaving living issue. C currently receives c of the net income of Trust, d beneficiaries receive e of the net income of Trust, and f beneficiaries receive g of the net income of Trust.

Upon the death of C, the income of Trust is to be divided into as many equal parts as there are great-grandchildren of A who are living or who have died leaving issue. On Date 2, Trust received Order from Court modifying Trust to add a provision that any child of C born after Date 3 shall not be a great-grandchild, a descendent or an issue within the meaning provided by the trust document, and that any such child shall not be entitled to receive any distributions of income or corpus from Trust. Accordingly,

upon the death of C, each of the beneficiaries is entitled to e of the corpus of Trust. As a result, while some beneficiaries' share of the income of Trust will increase, no beneficiaries' share of the income will decrease.

No corpus of Trust can be distributed prior to the termination of Trust. Trust will terminate h years after the death of C. On the termination of Trust, the corpus will be distributed in equal shares to the income beneficiaries in the same percentages as the income was distributed.

X and Trust have requested the following rulings:

(1) That each income beneficiaries' share in Trust is a substantially separate and independent within the meaning of section 663(c) of the Code such that each share shall be treated as a separate trust for purposes of §§ 1361(c) and (d);

(2) That each separate share qualifies as a qualified subchapter S trust (QSST) under section 1361(d)(3) of the Code; and

(3) That each income beneficiary can make an election under section 1361(d)(2) of the Code to have the separate trust treated as a QSST and that the shares that do not elect to be treated as a QSST may continue to be treated as an ESBT.

#### LAW AND ANALYSIS

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under section 1361(d)(2), the trust shall be treated as a trust described in section 1361(d)(2)(a)(i), and for purposes of section 678(a), the beneficiary of the trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under section 1361(d)(2) is made.

Section 1361(d)(3)(A) of the Code provides that a QSST means a trust the terms of which require that (i) during the life of the current income beneficiary, there is only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary, may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary.

Section 1361(d)(3)(B) provides further that the term QSST means a trust all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1361(d)(3) provides that a substantially separate and independent share of a trust within the meaning of section 663(c) shall be treated as a separate trust for purposes of section 1361(c) and section 1361(d).

Section 663(c) provides that, for the sole purpose of determining the amount of distributable net income in the application of sections 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts.

Section 1.663(c)-3(a) provides, in part, that the applicability of the separate share rule provided by section 663(c) will generally depend upon whether distributions of the trust are to be made in substantially the same manner as if separate trusts had been created. In determining whether separate shares exist, it is immaterial whether the principal and any accumulated income of each share is ultimately distributable to the beneficiary of such share, to the beneficiary's descendants, appointees under a general or special power of appointment, or to any other beneficiaries (including a charitable organization) designated to receive the beneficiary's share of the trust and accumulated income upon termination of the beneficiary's interest in the share. Thus, a separate share may exist if the instrument provides that upon the death of the beneficiary of the share, the share will be added to the shares of the other beneficiaries of the trust.

Section 1.1361-1(m)(6) provides that an ESBT election may be revoked only with the consent of the Commissioner. The application for consent to revoke the election must be submitted to the Internal Revenue Service in the form of a letter ruling request under the appropriate revenue procedure.

Section 1.1361-1(m)(7) provides that for a trust that seeks to convert from an ESBT to a QSST, the consent of the Commissioner is granted to revoke the ESBT election as of the effective date of the QSST election, if the requirements of that section are met.

## CONCLUSION

Based on the information submitted and the representations made, we conclude that each income beneficiaries' share of Trust constitutes a separate and independent share of Trust within the meaning of section 663(c) and that, provided that the income (within the meaning of §643(b)) is distributed currently, each separate share of Trust qualifies as a QSST under section 1361(d)(3).

Accordingly, as long as the requirements in section 1.1361-1(m)(7) are met, the ESBT election with respect to a separate share of Trust may be revoked by filing a QSST election for that share in the manner described in section 1.1361-1(m)(7). The revocation of the ESBT election for one or more separate shares will have no effect on

the current ESBT election for the separate shares of the remaining income beneficiaries. This ruling is contingent upon B disclaiming his interest in Trust effective Date 4 within 30 days of the date of this letter.

Except as specifically set forth above, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X is, in fact, an S corporation for federal tax purposes.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, a copy of this letter will be sent to Trust's and X's authorized representative.

Sincerely,

Faith P. Colson

Faith P. Colson  
Senior Counsel, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes

cc: